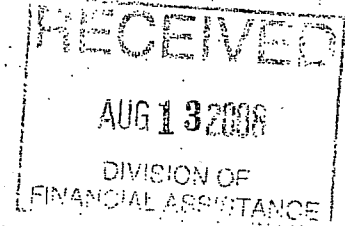




UNITED STATES ENVIRONMENTAL PROTECTION AGENCY

REGION IX

75 Hawthorne Street
San Francisco, CA 94105-3901



August 12, 2008

Barbara Evoy, Deputy Director
Division of Financial Assistance
California State Water Resources Control Board
P.O. Box 100
Sacramento, CA 95812

Dear Ms. Evoy:

Thank you for your comments on the draft 2007 California Clean Water State Revolving Fund (CW SRF) Program Evaluation Report (PER), which you provided in your letter dated August 6, 2008. We have incorporated your comments in the final enclosed PER.

On behalf of the review team, I would like to express my appreciation for the assistance your staff provided during the review. If you have questions about the final report, please call me at 415-972-3531 or the EPA Region 9 CWSRF program manager, Juanita Licata at 415-972-3450.

Sincerely,

Eric Byous, Supervisor
Infrastructure Office, Water Division

Encl: EPA Program Evaluation Report for California CWSRF Program

cc: Jerrel Bolds, SWRCB-DAS
Christopher Stevens, SWRCB-DFA
Doug Wilson, SWRCB-DFA

FISCAL YEAR 2007 PROGRAM EVALUATION REPORT

California Clean Water State Revolving Fund (CWSRF) Program

I. Introduction

Section 606(e) of the Clean Water Act (CWA) requires EPA to conduct an annual oversight review of the Clean Water State Revolving Fund (CWSRF) program to ensure compliance with the statutes, regulations, Operating Agreement (OA) and grant conditions governing the CWSRF. This is done by a continuous process of review and evaluation of "key program elements" discussed below. EPA allows the States to operate with as much flexibility as possible reflecting unique State needs but always performing within the framework of underlying program requirements.

EPA Region 9 conducted its annual review of the California CWSRF program on March 18 and 19 2008. The review was conducted by Juanita Licata, CWSRF Program Manager. William Dayton with the EPA Office of Inspector General (OIG), Office of Investigations also was present during the annual review to examine to what extent State CWSRF Programs are in compliance with sub-recipient monitoring requirements. A separate report will be compiled by the OIG upon completion of a national review on sub-recipient monitoring procedures.

The scope of the annual review includes consideration of the legal, managerial, technical, financial and operational capabilities of the State of California (State) specifically the California State Water Resources Control Board, Divisions of Financial Assistance (DFA) and Administrative Services (DAS).

EPA Region 9 used the SRF Annual Review Guidance and SRF Annual Review Checklist to ensure that all major elements of the program were reviewed and discussed with the California SRF management and staff. Transaction testing of program payments as required by EPA's HQ SRF management was also performed.

Following the review, EPA prepares a Program Evaluation Report (PER). This PER correlates with California's CWSRF Annual Report for the period ending June 30, 2007 and relevant activities through June 2008. The Annual Report, the Intended Use Plan, the Operating Agreement and an on-site review were used to prepare the PER. This PER highlights the review findings and identifies follow-up actions to be addressed in SFY2008/2009.

II. Program Status and Update

The period covered by this Annual Review is July 1, 2006 through June 30, 2007, (State Fiscal Year (SFY) 2007). As of August 7, 2002, the State administers the California CWSRF (the Fund) as a leveraged loan program. On this date, the Fund issued \$300,000,000 of California Infrastructure and Economic Development Bank, CWSRF

Revenue Bonds, Series 2002, dated August 1, 2002, with interest of 3% to 5%. The bonds provided funding for additional loans by the Fund.

At the time of issuance of the revenue bonds by the Fund, the Fund pledged in excess of \$850,000,000 of outstanding loans receivable of the Fund as security for the bonds. The principal and interest received during the fiscal year from these loans is to be used to make the annual debt service payments on the revenue bonds. The Fund utilizes the federal capitalization grant, state match, local share proceeds, repayments and bond proceeds to make loans for the construction of wastewater treatment facilities and to fund the implementation of nonpoint source pollution control activities. The federal fiscal year (FFY) 2006 capitalization grant in the amount of \$46,383,876 was awarded to the State on August 3, 2006; a required 20% match of \$9,276,775 brought the total capitalization award to \$55,660,651. The FFY 2007 capitalization grant in the amount of \$92,791,710 was awarded to the State on July 6, 2007 (i.e., SFY 08); a required 20% match of \$18,558,342 brought the total capitalization award to \$111,350,052.

III. Program Strengths

California's performance for the major CWSRF program financial indicators is above or within an acceptable range of the national average. California is maximizing the use and effectiveness of the CWSRF assets. California is also in full compliance with the CWSRF requirements for efficient, timely and expeditious expenditure of the funds.

Along with the traditional annual review, the State worked with EPA and Northbridge Environmental Consultants to perform a strategic management review of the State's CWSRF program and its processes. The "California CWSRF Strategic Management Review Report" (attachment A) was then issued on June 6, 2008, and summarizes and outlines suggestions for program and management enhancements. EPA commends the State's CWSRF managers for diligently recognizing the need for a strategic review of its program to ensure that it remains highly effective into the future.

Performance Indicators: The State is maximizing the use and effectiveness of CWSRF assets. California's performance for the top CWSRF program financial and programmatic indicators is above, within an acceptable range of the national average or as otherwise noted. The State's Annual Report detailed the accomplishments of the CWSRF. In SFY07, the State provided loan assistance for the construction of wastewater treatment facilities and water quality projects totaling over \$400 million.

Indicator	CW SRF 2007 ¹	
	California	National
Fund Utilization Rate	101%	97%
Return on Federal Investment	184%	231%
Initiation of Operation	66%	63%

¹ As of June 30, 2007, and as reported in the National Information Management System

Fund Utilization Rate: represents the cumulative assistance provided as a percent of cumulative SRF funds available for projects. California has done an excellent job in quickly converting funds to loans for CWSRF eligible projects and exceeds the National average.

Return on Federal Investment: represents the cumulative assistance disbursed as a percent of cumulative federal cash draws. This indicator is designed to show how many dollars of assistance were disbursed to eligible borrowers for each federal dollar spent. States with a direct loan program should have an expected value for this indicator of 120%, which reflects the 83% federal and 17% state contribution ratio for funding projects. States that leverage, such as California, should have a higher value than 120% because they have more funds available relative to the amount of federal funding than non-leveraged states. In California's case, the State has exceeded the standard level of performance, i.e., 120%. The 184% return on investment is in part attributed to the availability of more funds due to leveraging.

Initiation of Operation: date when the CWSRF funded project comes into operation or becomes capable of operation for the purposes for which it was planned, designed, and built. California has done an excellent job in quickly initiating operation of CWSRF projects and exceeds the National average.

EPA Strategic Plan: California has supported the EPA Strategic Plan by providing its annual goal to EPA in a timely manner every summer. California has updated its CWSRF Intended Use Plans (IUP) and Annual Reports to include strategic goals and environmental benefits. California completed the "one-pager" benefits form for each final loan agreement, which is included in their SFY 2007 Annual Report.

Administrative Service Charge: The State Water Board has successfully introduced Legislation, AB 1742, that will allow the CWSRF to establish an administrative service charge to supplement funds for the administration of the CWSRF. This legislation was approved by the Governor on October 13, 2007.

IV. Compliance with Grant Conditions and Assurances

California is managing the CW SRF program in accordance with State and Federal laws and regulations. California is in compliance with the conditions and assurances in the CWSRF Operating Agreement and grants.

On October 11, 2007, the independent auditors, Clifton Gunderson LLP, opined that the financial statements of California State Water Resources Control Board, Water Pollution Control Revolving Fund presented fairly, in all material respects, the financial position of the Fund as of June 30, 2007 and 2006. The auditors noted no matters involving the internal control over financial reporting and its operation that would be considered to be

material weaknesses.

The following conditions and assurances regarding the required program and financial elements have been reviewed and do not require any further discussion unless otherwise noted in Section V of this report.

Required Program Elements

- A. Annual Report
- B. Funding Eligibility
- C. Compliance with DBE Requirements
- D. Compliance with Federal Cross-Cutting Authorities
- E. Compliance with Environmental Review Requirements
- F. Operating Agreement
- G. Staff Capacity

Required Financial Elements

- H. State Match
- I. Binding Commitment Requirements
- J. Rules of Cash Draw
- K. Timely and Expeditious Use of Funds
- L. Compliance with Audit Requirements
- M. Assistance Terms
- N. Use of Fees
- O. Assessment of Financial Capability and Loan Security
- P. Financial Management
- Q. Other Program and/or Financial Elements

V. Program Review Observations, Follow-up Action Items and State Response

EPA's review assessed certain program, financial and project management practices as they relate to the State's ability to effectively administer the program. This section presents specific observations and suggests desired action items that can be incorporated into the future operations or management of the program. The State may comment on the stated observations and suggestions.

A. Annual Report and Strategic Management Review Report

1. Annual Report Observations: The State submitted an interim Annual Report for SFY ending June 30, 2007 on October 1, 2007 followed by a final report to EPA on November 13, 2007. The final report, which is submitted to the Board, includes the audited financial statements and report. The State's Annual Report provided a full and good explanation of CWSRF program status and activities, audit findings, recommendations and/or events affecting the performance of the CWSRF program. EPA found that certain SRF performance activities or accomplishments stated in the 2006/2007 Annual Report were inconsistent or had slight discrepancies. For example,

we noted a discrepancy in the number of loans reported in the Annual Report (page 12, "18 of the 24 projects listed in the SFY 2006/2007 IUP were funded") versus the number of projects listed and described in the Annual Report (pages 12-15), which shows 16 not 18. The number of projects shown for 2007 in the NIMS report also lists 24 projects.

Follow-up: Differences such as these should be reconciled and if valid should be explained.

State Comments: *Ms. Juanita Licata of the U.S. Environmental Protection Agency and Mr. Doug Wilson of our staff discussed this comment on July 8, 2008. They agreed to disregard this comment.*

EPA Comments: The number of the projects listed and described in the Annual Report and NIMS is correct no follow-up was necessary.

2. Strategic Management Review Observations: In early SFY 2008 the Board worked with EPA and Northbridge Environmental Management Consultants to begin a strategic review of the Program. The review's final findings and recommendations were issued in June 2008 and compiled in the enclosed *California Clean Water State Revolving Fund Strategic Management Review*. This strategic review serves as a supplemental document to the PER and provides a third party evaluation and assessment of the Program's current practices along with recommendations for improvements.

As part of the review, Northbridge staff conducted an online customer survey, and interviewed staff in the State and Regional Water Boards, as well as the I-Bank to better understand processes and procedures, identify challenges confronting the CWSRF program, and suggest solutions for the state's consideration.

The strategic review was extremely productive and has guided California CWSRF management and staff in taking significant steps to implement many of the key financial and programmatic review recommendations. Some of the major actions taken by the Program to increase its reach, make the Program more effective for its customers, and the job easier for State managers are listed as follows:

- Staff has been hired to improve and strengthen the Program's outreach and marketing to potential borrowers and Regional Water Board staff.
- An in-house workgroup has been established to review the application process and look for ways to streamline, simplify and improve this process internally and externally.
- Management will offer extended term financing (30 year loans) to target projects in small and disadvantaged communities.
- To strengthen the Program's financial capability review process, the Program has contracted with CalMuni to perform credit reviews of potential loan applicants.
- To increase financial planning capacity, the Program will contract with Northbridge Environmental Management Consultants to assist with the design and implementation of a lead CWSRF financial management function.

Follow-up: The strategic review report summarizes the issues and provides options for improvements. The Program, as noted, has started implementing a selection of options and should continue to assess implementation of the other options for improvement identified in the report. To capture and track the ideas and strategies that the Program plans to implement we suggest that the Program develop an implementation and milestone schedule. This schedule should briefly describe action items and work in progress and should be updated on a quarterly basis. A schedule will allow the Program to keep management and other key stakeholders informed of the Program's approach and progress for achieving its overall financial, environmental and programmatic goals.

State Comments: *Staff completed a summary of the recommendations and a status of the current implementation (please see attached copy). In addition, a letter was sent to Ms. Alexis Strauss on July 14, 2008, with the same information.*

3. Long-Term Goals Observation: The Program's long-term goal as stated in the Annual Report "to maintain at least an 80 percent rate of loan issuance...." was established early on in the program and prior to the State leveraging in 2002. Over the past 6 years, the Program has exceeded its goal of 80% and has clearly demonstrated an ability to quickly convert funds to loans at a rate of 90% or greater.

Follow-up: Based on the Program's trend over the past 6 years to meet or exceed the National average, we encourage the State to revise this goal to represent a realistic percentage rate of fund utilization for its Program.

State Comments: *The Division of Financial Assistance (Division) agrees that the target minimum issuance rate of 80 percent is too low. Please note that the target rate in the 2007/2008 IUP was 95 percent. The Division plans to propose a rate of 100 percent of available funds in the 2008/2009 IUP scheduled for adoption by the State Water Resources Control Board on September 16, 2008.*

B. Compliance with Audit Requirements

1. Annual Audit Observations: The *Independent Auditor's Report on Compliance with Requirements Applicable to the Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133* noted no findings required to be reported under OMB Circular A-133. It is the opinion of the auditors that the financial statements presented fairly, in all material respects, the financial position of the California State Water Resources Control Board, Water Pollution control Revolving Fund and there were no findings required to be reported under generally accepted Government Auditing Standards.

Follow-up: None

C. Financial Management

1. Financial Management Observations: To comply with a U.S. Office of Management and Budget (OMB) policy requirement to evaluate improper payments, each Region is required to perform transaction testing on two separate payments for the State CWSRF program annually. We tested 2 financial transactions which drew a total of over \$3.2 million from the federal treasury between July 1, 2006 and June 30, 2007. Our review of these financial transactions found that there were no improper payments.

	\$\$\$ Amt of Federal Transactions	# of Transactions	# of Projects
Clean Water SRF	\$3,265,168	2	3

Follow-up: None.

VI. Project File Review

EPA project file review found the projects to be eligible and in compliance with the program requirements. Project files were complete and well maintained. EPA reviewed the following project files:

(1) City of Piedmont, #4655-130, CWSRF loan amount = \$2,512,708. The project consists of rehabilitating approximately 29,500 feet of 6" through 12" sanitary sewer main and 3,500 feet of service laterals by pipe bursting method, performing point repairs, and installing sanitary sewer manholes. This third phase of the Piedmont Sanitary Sewer Rehabilitation Project for sub-basins T1 and W5 will meet the California Regional Water Quality Control Board, San Francisco Bay Region adopted Cease and Desist Order No. 93-134 (CDO) prescribing requirements for the discharge of sewer system overflows. It will meet the compliance dates set in the October 1993 Compliance Plan.

(2) Susanville Consolidated Sanitary District, #4753-110, CWSRF loan amount = \$4,869,259. This project is to expand the existing WWTP and increase the rated average capacity to 2.1 million gallons per day (MGD) with a peak capacity of 4 MGD. The current plant has trouble handling peak wet weather flow in excess of 1.2 MGD, and must pump the excess to existing holding ponds.

VII. Conclusion

We have conducted an annual review of the California Clean Water SRF Program for program year 2007 in accordance with EPA's SRF Annual Review Guidance. Based upon the file reviews, on-site project file reviews and interviews, EPA concludes that the State of California has administered the program in general compliance with the Capitalization Grant Agreement. EPA is pleased with the continual progress in program improvements and financial oversight. We look forward to working with the State to implement the Program Evaluation Report follow-up action items in SFY 2008/2009.